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Recent changes to the Swiss regulatory rules on market abuse and takeovers

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In the context of a larger overhaul of the regulatory framework on insider trading, market abuse and similar practices, the Swiss legislator has recently passed an amendment to the rules of the Stock Exchange Act (SESTA) governing the disclosure of shareholdings and the minimum price rules applicable in a public tender offer. In particular, the new rules will:

- Extend the reach of the act to shares in companies with registered offices outside Switzerland.
- Expand the supervision of the Swiss Financial Supervisory Authority (FINMA) regarding compliance with disclosure obligations of market participants.
- Change some important procedural provisions.
- Abolish the possibility for a bidder to pay a control premium to the controlling shareholders of a target company shortly before the launch of a public tender offer, which is the most significant and controversial change.

ABOLITION OF CONTROL PREMIUM

Minimum price rules

Under the current SESTA provisions, any shareholder who acquires a controlling interest (more than one-third of the voting rights) in a listed company must make a public offer to purchase all other listed equities (unless the listed company has adopted an opting up or an opting out clause). Such mandatory offers (and also voluntary offers that are extended to more than one-third of the voting rights of a listed company or to the higher number of shares in an opting up) must provide an offer price that meets a two-part minimum price rule. Such an offer price must both:

- At least equal the current stock exchange price (that is, the volume-weighted average price of the last 60 trading days preceding the offer's pre-announcement (if any) or announcement).
- Not be below 75% of the highest price that the bidder, and any persons acting in concert with the bidder, paid for equities of the listed company in the last 12 months.

As a consequence of this second requirement, the bidder may, to a limited extent, pay the selling (major) shareholders a higher price for their shares before the publication of the public offer than is offered under the public offer to the remaining shareholders. The current rules therefore accept a differentiation between shareholders whose shares are acquired in a first step at a higher price (almost always shareholders holding significant interests in the target company conveying together relative or

absolute control over the target) and other shareholders (bigger and smaller) whose shares are only acquired in a second step at a lower price. The shareholders in the first group can profit from a control premium, while the shareholders in the second group must accept a minority discount. The maximum premium allowed by the current takeover regime, where a controlling interest is acquired before and independently of the launch or success of the public offer, is therefore one-third of the price offered in the subsequent public offer.

The limitation on the control premium amount applies for a period of 12 months before the (pre-)announcement of the public offer. Once the offer is officially announced, the best price rule becomes applicable, forcing a bidder that acquires any shares at a higher price than the offer price to pay this price to all target company shareholders. The best price rule remains applicable after the end of the (additional) offer acceptance period for a further six months.

The current rules therefore allow for a structure that resembles a two-tiered tender offer in other jurisdictions. The acquirer can offer a better price for a limited number of shares of the target company in order to gain control, while offering only a reduced price for an additional number or the remainder of the shares at a later date. This has significant benefits from the perspective of the acquirer. Most importantly, the overall cost of the tender offer using a two-step approach is reduced, in comparison to a tender offer at the same price extending to all outstanding shares. In addition, the shareholders of the target company in a two-tiered tender offer will be likely to tender their shares more quickly, to avoid being placed in the second tier and receiving a lower offer price. If the bidder has already acquired a controlling interest in the target company, there is no risk of a competing offer. The remaining shareholders are essentially forced into accepting the offer in order not to be at risk of ending up holding illiquid shares and receiving a lower payout at a later date similar to the shareholders in a two-tiered tender offer.

As a result, bidders launching a public offer with a significant interest in the target company, even if short of a controlling interest, are more likely to succeed with their takeover attempts since they are able to discourage and/or fend off potential third party bidders and to suffocate potential resistance, if any, from the target company itself. At the same time, the possibility of paying a control premium to some shareholders but not to others disadvantages minority shareholders who have to accept a price that is up to 25% below the price offered to the significant shareholders before the public offer.



Bidders in the past have been reluctant to pay selective premiums to significant shareholders, even though the provisions allowing this possibility have been in force since the introduction of the SESTA in 1997. However, it has become progressively more usual to employ selective control premiums in public offers, despite the fact that Swiss media have often heavily criticised the payment of a premium to the majority shareholder(s). Cases in the recent past involving significant control premiums ranging from 20% to 33.3% include the takeovers of Hiestand Holding AG, sia Abrasives Holding AG, Quadrant AG and Bank Sarasin & Cie AG.

Abolition of control premium

The abolition of this control premium was brought forward by the Federal Government based on a proposal by the Takeover Board. This proposal was also supported by SIX Swiss Exchange, the larger of the two official stock exchanges in Switzerland. The main argument brought forward by the proponents of this change is that the control premium significantly violates the principle of equal treatment and transparency and, therefore, violates the legitimate interests of minority shareholders in a public takeover. This has been triggered by the growing use of significant premiums in the recent past and the apparently increased willingness of both acquirers and sellers of substantial shareholdings to share the advantages of an unequal treatment of shareholders and take the public blame for such perceived unfairness. In the opinion of the SIX Swiss Exchange, the possibility of paying a control premium to one or several significant shareholders was a significant disadvantage for the Swiss financial market's international competitiveness. A further argument used was that this option had been abolished in most European countries, since EU member states cannot allow for any control premiums under their national laws under EU takeover offer guidelines.

Conversely, the opponents of abolition argued mainly that abolition was an unjustified infringement of the principle of freedom of contract, since the ability to sell a controlling interest represents an economic value that should justify being compensated by a control premium paid to the holder. In addition, the defender of the current statutory regime argued that abolition would necessarily lead to an increase of the overall costs for a takeover and, therefore be likely to prevent a takeover in many cases. These arguments were the subject of heated debate both in the legislative consultation procedure as well as in both chambers of the Swiss Parliament. The latter decided after a long controversial debate with a narrow margin to abolish the control premium as proposed by the Federal Council and the Takeover Board.

As a result, the revised version of Article 32, paragraph 4 of the SESTA provides that the price of an offer must at least equal both the current stock exchange price and the highest price paid by the bidder for shares (or other equity securities of the target company) in the 12 months preceding the announcement of the offer. These revised provisions therefore effectively prevent a bidder from acquiring a block of shares from a significant shareholder pre-offer at a price exceeding the offer price offered to the remaining (minority) shareholders. A bidder who wants to acquire or a significant shareholder wanting to sell a significant block of shares at a higher price than offered to the public must do so at least 12 months before the announcement of the offer.

The acquired interest must be below one-third of the voting rights (together with any shares already held by such bidder or any parties acting in concert with it) in order not to trigger a mandatory public offer, unless the articles of association of the target company either:

- Increase the relevant threshold for a mandatory public offer (opting up).
- Waive the applicability of the mandatory tender offer rules, including the minimum price rules, altogether (opting out).

MARKET ABUSE

General

Various statutory provisions and regulatory rules address insider trading and fair market conduct. Article 161 of the Swiss Penal Code is the most important provision, which prohibits the misuse of material privileged non-public information or the manipulation of a security's price by communicating or distributing false information to the public.

The offences of insider trading and manipulation of share prices are to be transferred from the Penal Code to the Stock Exchange Act. The Federal Council aims to sanction market abuse more efficiently with the revision of the Stock Exchange Act, thereby enhancing the reputation and competitiveness of the Swiss financial centre. The constituent elements of insider trading in particular will be extended and stated more precisely under criminal law. It will now be prohibited for anyone obtaining knowledge of inside information to exploit such insider information. In addition, the acquisition of a pecuniary advantage of more than CHF1 million through the criminal action of a primary insider (*see below, Insider trading*) is considered a felony and will in the future be classified as a predicate offence for money laundering. In addition, insider trading and market manipulation will be prohibited under supervisory law for all market participants. Exceptions to these restrictions, such as for the repurchase of financial interests within the scope of public buyback programmes and securities transactions for price stabilisation purposes following a public placement, will be defined in the Stock Exchange Ordinance.

Insider trading

The current Article 161 of the Penal Code applies to any person who is a member of the board of directors or management board, auditor or agent of a stock company or of a company controlling or controlled by such a company. These persons are liable to a custodial sentence if they obtain a financial advantage for themselves or another by using or making known to a third party confidential information, the knowledge of which could have a substantial and foreseeable influence on the price of listed or pre-listed shares, securities, book entry securities, or options traded on a Swiss stock exchange.

The definition of inside information in the new Article 40 of the SESTA has been modified to avoid ambiguity. Information is considered to be inside information when it is confidential and when the disclosure of such information is likely to have a significant effect on the share price of securities that are traded on the stock exchange or similar share trading platforms in Switzerland. The revision makes it clear that it is sufficient for shares to be classified as securities if they have been admitted for trading and an actual listing is not required. A share price fluctuation of 5% is sufficient to qualify as significant.



In addition, there are three types of potential offenders, each of which must act with intent and procure a pecuniary advantage:

- The primary insider, who is someone who acts in his capacity as a member of an executive body of an issuer or a company that either controls or is controlled by the issuer. It is sufficient for such person to have access to insider information.
- The secondary insider, who is someone that has obtained inside information from a primary insider or has obtained this information by committing a felony or misdemeanour.
- The tertiary insider, who is neither a primary nor a secondary insider but obtains knowledge of inside information and exploits it for his own benefit. A tertiary insider was not a potential offender before the revision.

Primary insiders are not restricted to persons that are part of a management body or who are in a relationship of trust to the company. The newly introduced Article 40 of the SESTA considers a primary insider to be any person who is intended to have access to insider information due to their participation or activities. An additional criminal action has been introduced and it is now sufficient for the primary insider to make recommendations to buy or sell securities, and an explicit revelation of the insider information is not necessary.

Market and share price manipulation

Any person is liable to a custodial sentence who, with the intention of exerting a significant influence on the price of securities traded on a Swiss stock exchange in order to secure an unlawful financial gain for himself or another, either (*Article 161bis, Penal Code*):

- Wilfully disseminates misleading information.
- Purchases or sells the relevant securities (where the purchase and sale are entered into directly or indirectly for their own benefit or that of linked persons).

Article 161bis of the Penal Code will be transposed into the new Article 40a of the SESTA, which makes clear that in future persons disseminating misleading information as well as incorrect information will fall under the prohibition.

Enhanced regulatory oversight by FINMA

In the past exploiting inside information was sanctioned with criminal-law consequences and legal intervention by regulators had been limited to those actors over which FINMA exercises regulatory oversight. Following the revision of the SESTA and the Stock Exchange Ordinance, FINMA can now take action against all persons who use insider information or engage in market manipulation. This means that the SESTA provides for the first time at supervisory law level specific statutory provisions that prohibit all individuals and legal entities participating in the financial markets from engaging in insider trading and market manipulation. Before this, FINMA and its predecessor the Swiss Federal Banking Commission (SFBC) could only enforce market conduct rules against supervised market participants. Following these changes in the SESTA, FINMA is currently also revising its circular on market conduct rules. The first part of the circular, applicable to all individuals and legal entities active on the financial market, details the general rules on preventing insider information and market manipulation. The non-exhaustive list provided in the circular includes abusive practices such as scalping, spoofing, wash trades, banging the close, and so on.

In addition, the sections of the circular focusing on organisational requirements will also be revised and their reach will be extended. This means that the organisational requirements will no longer only be directed at securities dealers, but also at all institutions under prudential supervision, although it will differentiate between each supervised institution depending on its business activities, size and structure. According to the provisions of the revised circular, when assessing the business conduct of an institution under prudential supervision, FINMA will not only supervise its securities dealing on Swiss stock exchanges but also its securities dealing in the primary market and on foreign stock exchanges, and business activities conducted on commodities and foreign exchange markets, if any.

RULES ON DISCLOSURE AND TAKEOVER

The disclosure and takeover rules will be applicable to both:

- Companies having their registered seat in Switzerland
- Companies having their registered seat abroad, whose shares are mainly listed in Switzerland.

Before the revision, the disclosure and takeover rules were solely applicable to companies whose shares were mainly listed in Switzerland and that had a registered seat in Switzerland.

Rules on disclosure

Article 41 of the SESTA currently punishes with a fine persons who intentionally either:

- Fail to notify a qualified shareholding in a listed company.
- As the owner of a qualified shareholding in an offeree company, fail to disclose the purchase or sale of equity securities of that company.

The fine can amount to up to double of the purchase price or the sale proceeds, and is calculated based on the difference between the new shareholding held by the person, who is subject to an obligation to notify and the last shareholding declared. This way of determining the fine under Article 41 of the SESTA is highly problematic from a constitutional point of view. Therefore, the new Article 41 of the SESTA will provide for a maximum CHF10 million cap for such fines.

Violation of the offer obligation

The new Article 41a of the SESTA will be introduced to improve the implementation of the offer obligation. Should individuals intentionally not make a mandatory offer, they can be fined up to an amount of CHF10 million.

FUTURE DEVELOPMENTS

The abolition of the control premium may result in an increase in the introduction of opting out clauses to avoid mandatory offer obligations and the minimum price rules. However, the Takeover Board has already taken the expected limitations on control premiums into consideration in a recent decision where it required the affirmative votes of a majority of the disinterested shareholders present at the shareholders' meeting for the introduction of an opting out clause, a more stringent practice. In addition to opting out situations, a selective premium also remains possible, to the extent agreed before, and independent of, the public offer, if the bidder already holds shares exceeding the threshold for a mandatory offer.



The transfer of the market abuse offences from the Penal Code to the SESTA is expected to allow for a broader, faster and more efficient prosecution of suspected violation of market abuse rules. The advantages include that:

- Regulatory action can now be initiated by FINMA against abusive behaviour carried out by any market participant, whether or not subject to FINMA supervision, including the issuing company itself. In addition, regulatory action can be initiated more swiftly as it is not constrained by more rigid requirements which are necessary to initiate criminal proceedings.
- Instead of various different cantonal authorities, the same prosecution authority (the Office of the Attorney General of Switzerland) will be competent and in charge of investigating and prosecuting suspected violations, and the same court will be competent for any convictions (the Federal Criminal Court).
- FINMA can now take action against all persons who use insider information or engage in market manipulation, not only regulated market participants, and can request or exchange information relating to alleged market abuse, or market participants suspected to have violated applicable market rules, from foreign supervisory authorities.
- When assessing the proper business conduct of a regulated institution subject to FINMA supervision, FINMA will also look at the securities dealing in the primary market, on foreign stock exchanges and business activities conducted on commodities and foreign exchange markets.

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